Chapter One

Introduction

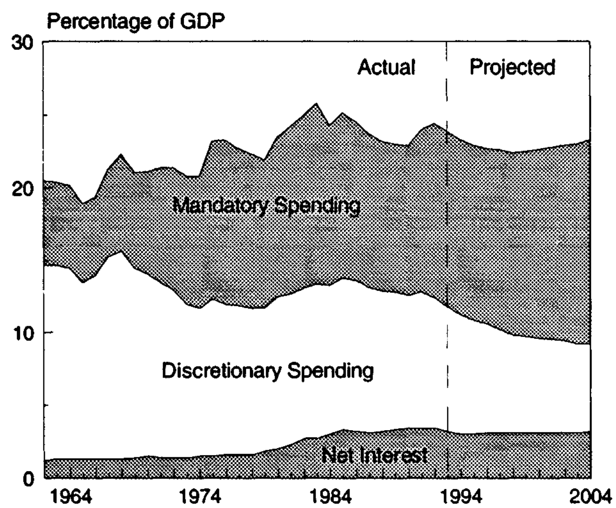
During the 1980s and 1990s, the federal budget deficit has exceeded 2.5 percent of gross domestic product (GDP) every year, an unprecedented stretch of peacetime deficit spending. Although the spending constraints of the Budget Enforcement Act of 1990 are expected to hold the deficit at roughly this share of GDP for the next few years, the Congressional Budget Office (CBO) projects that the deficit will grow faster than GDP each year thereafter if current policies are maintained. In dollar terms, CBO projects that the deficit will rise from about $200 billion in 1994 to almost $400 billion in 2004. Ever-mounting federal deficits directly reduce national savings and threaten the growth of U.S. living standards.

Many factors have combined over recent decades to produce the nation's deficit problem. Federal spending has grown as a percentage of GDP while revenues have claimed a relatively constant share. The growth in spending has come from different movements of the three major components of federal expenditures (see Figure 1).[1]

- *Discretionary spending* encompasses programs controlled by annual appropriation bills. It includes funding for defense, international activities, and domestic programs such as transportation, law enforcement, and government operations. Expenditures for this category have shrunk by more than one-third over the past three decades, falling from 13.5 percent of GDP in 1962 to slightly more than 8 percent in 1994.

- *Mandatory spending* consists overwhelmingly of entitlements such as Social Security, Medicare, and Medicaid, government programs that make payments to recipients who meet criteria specified in law and who apply for funds. Mandatory spending has doubled over the 1962-1994 period--from 6 percent to 12 percent of GDP.

Figure 1.
Components of Federal Spending as a Percentage of Gross Domestic Product, 1962-2004



SOURCE: Congressional Budget Office.

1. Government spending also includes two smaller categories. *Offsetting receipts* are fees and similar charges that the budget records as negative outlays. *Deposit insurance spending* reflects the government's commitments to protect deposits in insolvent institutions minus the fees charged for this insurance.

- *Net interest spending* includes federal interest payments to the public less interest income received by the government. Driven by the quadrupling of the national debt since 1980 and by market interest rates, net interest has also more than doubled since 1962, rising from 1.2 percent to 3.0 percent of GDP.

The figures above point to a clear conclusion: any attempt to reduce the budget deficit that does not involve increasing the share of income claimed by taxes must curb the rapid growth of mandatory spending--particularly spending for entitlements. The Congress has already sharply constrained discretionary spending to the point where many Members argue that further cuts would be destructive. Beyond making decisions that affect the size of the debt, the Congress has little control over net interest spending. CBO projects that if entitlements are not constrained, they will grow to 14 percent of GDP over the next 10 years.

The rapid growth of entitlements, combined with reductions in spending for defense and other discretionary programs, has raised the entitlement share of outlays from 30 percent in 1962 to 54 percent in 1993. If present policies continue, entitlements could constitute nearly two-thirds of all federal spending by early in the next century. The aging of the baby-boom generation will drive that fraction still higher over succeeding decades. What are the major entitlements that are generating this growing category of federal spending? And what approaches might the Congress pursue to bring that growth under control?

The Major Entitlement Programs

Entitlement programs span a wide range of activities that give cash or in-kind assistance to recipients. The diverse programs provide benefits to individuals, families, businesses, or units of government that meet specific criteria established in law. Qualified parties who apply receive benefits based on formulas that are codified in law and not subject to annual appropriation action by the Congress.

The federal government's major entitlement programs can be grouped in four categories.[2] *Cash social insurance programs* provide cash payments to qualifying individuals without respect to their economic well-being. This category includes Social Security's Old-Age and Disability programs, unemployment compensation, veterans' compensation and pensions, and agricultural price supports.[3] Those programs accounted for almost half of all federal entitlement spending in 1993, with 80 percent of that share going for Social Security benefits (see Table 1).

Two *health insurance programs*, Medicare and Medicaid, pay for health care services for elderly, disabled, and poor people. Medicare benefits are not subject to a means test; that is, beneficiaries do not lose benefits as their incomes rise. In contrast, Medicaid assistance goes only to families with limited financial resources. Together the two programs consumed almost a third of all entitlement spending in 1993.

About 10 percent of federal outlays for entitlements finance *means-tested assistance programs*. Such programs offer aid in cash and in kind to families with low incomes and assets. Aid to Families with Dependent Children (AFDC) and Supplemental Security Income (SSI) provide cash assistance. The Food Stamp program offers vouchers that recipients can use to purchase food. The earned income tax credit (EITC) makes cash payments to taxpayers with limited earnings who qualify for tax credits that exceed what they owe in federal income taxes.

2. The categorization used in this study is neither precise nor comprehensive. For example, because of limitations in the available data, veterans' pensions are included under cash social insurance programs, even though, unlike other such entitlements, they are paid only on the basis of need. Medicaid is listed here as a health program but could have been included under means-tested assistance. The study does not discuss the government's smaller entitlement programs, which include family support programs other than Aid to Families with Dependent Children, child nutrition programs, student loan programs, social services, and credit reform accounts.

3. Federal pensions and most means-tested benefits also involve cash payments but are considered under separate categories in this study. Pensions fall under a different rubric because they are part of the labor contract between government workers and their employers. Means-tested benefits are classified separately because they provide an economic safety net for low-income families.

Finally, *government retirement programs* provide pensions for federal civilian and military retirees. These programs account for nearly one-tenth of entitlement spending.

The principal beneficiaries of these entitlements are the elderly. Social Security and Medicare benefits make up nearly 60 percent of all entitlement spending, and roughly five-sixths of that amount benefits people age 65 or older. The elderly also receive about 10 percent of other such spending, bringing their total share of all entitlements to nearly 60 percent.

People with low incomes also benefit substantially from entitlement programs. Means-tested benefits, which go only to these families, account for about one-fifth of all entitlement spending. However, because some benefits that are not means-tested also go to the poor, the fraction of entitlement benefits that assist poor families and individuals significantly exceeds one-fifth.

CBO projects that spending for entitlements over the next five years will grow by about 3 percent annually in real terms--that is, after adjusting for inflation.

Table 1.
CBO Baseline Projections of Mandatory Federal Spending by Program, Fiscal Years 1993 and 1999

	1993 (Actual)		1999 (Projected)		
	Billions of 1993 Dollars	Percentage of Mandatory Spending	Billions of 1993 Dollars	Percentage of Mandatory Spending	Average Annual Percentage of Real Growth, 1993-1999
Cash Social Insurance Programs					
Social Security and Railroad Retirement	302	40	342	37	2.1
Unemployment compensation	35	5	23	3	-6.5
Veterans' compensation and pensions	21	3	18	2	-2.2
Agricultural price supports	16	2	8	1	-11.8
Subtotal	374	49	391	42	0.8
Health Programs					
Medicare	143	19	220	24	7.5
Medicaid	76	10	126	14	8.9
Subtotal	219	29	347	38	8.0
Means-Tested Assistance					
Aid to Families with Dependent Children and other family support	16	2	17	2	0.8
Supplemental Security Income	21	3	29	3	5.7
Food stamps	25	3	26	3	0.6
Earned income tax credit	9	1	21	2	15.1
Subtotal	71	9	93	10	4.3
Government Retirement Programs					
Federal civilian pensions	39	5	43	5	1.5
Military pensions	26	3	29	3	2.0
Subtotal	65	8	72	8	1.7
Other Mandatory Outlays	34	4	23	3	-6.0
Total	762	100	927	100	3.3

SOURCE: Congressional Budget Office.

Under current law, only three programs will exhibit particularly rapid growth (see Table 1). Spending for Medicare and Medicaid will increase about 8 percent annually in real terms. (That projection assumes that the Congress does not enact significant health care reform legislation and the health care industry remains relatively unchanged.) The EITC will also expand rapidly because of substantial changes made in the Omnibus Budget Reconciliation Act of 1993. Outlays for the program will grow 15 percent a year in real terms through 1999 but will then level off.

Approaches to Reducing Entitlement Spending

The approach usually taken to constrain entitlement spending involves cutting spending program by program. The Congress has followed that path in its previous efforts at control. An alternative approach, which has not yet been tried, derives from the premise that a government with fiscal problems should not provide benefits to those who have little need for government support. This strategy would be global rather than program based, using some form of means-testing to limit eligibility (and thus expenditures) for all entitlement programs. Several recent proposals follow that approach. The broad range of global options also includes making more entitlement income subject to the federal individual income tax.

Changes to Individual Programs

Most of the legislative changes in entitlements over the past 15 years have focused on three methods for curbing spending: reducing cost-of-living adjustments (COLAs), limiting payments to providers of medical care, or restricting eligibility for benefits. Current proposals would use similar methods. The Congress delayed or denied COLAs in some years (1981, 1982, 1985, and 1993) to lower spending for federal civilian and military retirement and disability programs. In addition, COLAs were the tool used to obtain the largest short-term cut in spending generated by the Social Security Amendments of 1983. H.R. 4245, the Social Security Long-Range Solvency Act of 1994, proposes a one-time reduction in the COLA for Social Security to reduce benefits for current recipients.

Virtually every budget reconciliation bill enacted over the past decade has restricted Medicare reimbursements (or the annual increases in reimbursement rates) for services provided by hospitals and doctors. The sequestration required in fiscal year 1986 under the Balanced Budget and Emergency Deficit Control Act of 1985 took the same tack. The different health care reform bills considered by the 103rd Congress would have reduced federal spending for Medicare and Medicaid in a variety of ways including lowering reimbursement rates for hospital care, limiting payments to other health care providers, and moving some beneficiaries from Medicaid to coverage under private health insurance. Some plans would also have increased the premiums that enrollees pay for benefits from Medicare's Supplementary Medical Insurance (Part B).

Tightening eligibility requirements to lower outlays was primarily limited to the Omnibus Budget Reconciliation Act of 1981. That action focused on AFDC and the Food Stamp program, both of which are means-tested. The Social Security Long-Range Solvency Act proposes to raise the age at which annuitants could receive full benefits and to cut benefits for future retirees who had high average earnings during their working years.

Another approach that the Congress has considered to lower the net cost of entitlement programs is counting benefits as taxable income under the federal individual income tax. Most entitlement benefits are not taxed. But some--notably unemployment compensation and federal civilian and military pensions in excess of pensioners' contributions--are fully taxable, as are up to 85 percent of Social Security payments to middle- and high-income recipients.

Constraining entitlements program by program recognizes that each one has its own constituencies and purposes. Indeed, the Congress designed the eligibility requirements and levels of benefits of the programs with an eye to achieving those specific goals. Lumping all of the entitlements together and applying a single limit to the resources of all potential beneficiaries would fail to take account of important differences between programs as varied as assistance for the poorest Americans, pensions the government has promised its employees as part of their labor contract, and benefits for the elderly for which recipients have paid payroll taxes during their working years. Furthermore, applying the same means test in determining benefits for recipients in different age cohorts would ignore changes that have occurred over time in the tax contributions recipients have made to program trust funds.

The major drawback to reducing entitlements one by one is the difficulty of achieving the consensus required to change individual programs. Decisions about how to cut benefits fairly across different programs would pose dilemmas not easily resolved. These problems argue for considering a broader approach to limiting entitlement spending.

Changes to Entitlement Programs as a Group

A number of the recent proposals for global reduction of entitlements have a common theme: reducing or eliminating all entitlement benefits for higher-income recipients. Proposed amendments to bills before the Senate would have denied emergency unemployment benefits to individuals with high incomes. The Concord Coalition--a bipartisan organization headed by former Members of Congress that focuses on fiscal policy--in *The Zero Deficit Plan* and Presidential candidate H. Ross Perot have proposed reducing the benefits that middle- and high-income families receive from entitlement programs as a group while leaving individual programs unaltered. Peter Peterson in his book *Facing Up* argues for cutting benefits in specific programs and reducing benefits more broadly with methods similar to those of the Concord Coalition. Peterson further suggests broadening the definition of taxable income to include entitlements as a way to offset entitlement spending with additional revenues.

Such a global approach--either through means-testing or by taxing benefits--may seem to be a more direct way to curb spending than cutting individual programs. But it may have unpredictable--and undesirable--effects. The specific goals of some programs could be compromised in unintended ways. At the same time, applying a single yardstick to all entitlements might be considered more equitable than ad hoc adjustments made to each program individually.

One approach would impose a global means test to limit or deny entitlements to high-income individuals. A means test would help to restrain federal spending by requiring greater sacrifices from those most able to bear the cost. In addition, it would impose those sacrifices not on wealthier people in general but rather on those wealthier people who benefit from the programs that are involved.

The income threshold above which benefits would be cut and the rate at which cuts would be made determine which recipients would be affected by such means-testing. Higher thresholds would exempt more current recipients from cuts; rates of benefit reduction that rose more gradually or were limited to less than 100 percent would protect a larger share of benefits. Both actions, however, would limit the budgetary savings from the means test.

An alternative approach--requiring those who receive benefits to pay income taxes on them--would achieve the same ends as limiting benefits and would be in keeping with the objective of a broad-based tax system that treats all forms of income similarly. Although Social Security benefits are much like private pensions --both are earned during one's working years and are paid for through reduced take-home pay--the federal tax system treats them differently: it levies no taxes on the benefits of three-fourths of all Social Security recipients, but it fully taxes all private pension payments in excess of a person's contributions. Although some entitlements are taxable--including unemployment compensation, federal and military pensions, and veterans' compensation--others are not; yet income from those untaxed sources is no different from income from private sources that is subject to taxes.

Making all entitlements subject to federal income taxes could improve the equity of the tax system and provide revenues to offset some of the costs of entitlements. Furthermore, this approach would take advantage of the existing structure of the income tax and the system that administers it. At the same time, to the extent that the Congress sets benefits assuming that they will not be taxed, imposing taxes on those entitlements would reduce the net benefits that people receive below the amounts that the Congress has deemed appropriate.

For this study, CBO examined specific policy options to constrain net spending for entitlements as a group. To preface that examination, however, it investigated the distribution of entitlement benefits among families by income category and family type, considering arguments for and against means-testing particular benefits (see Chapter 2). Three policy options were formulated: taxing all entitlement benefits, reducing benefits for middle- and high-income recipients, and denying benefits to high-income recipients. Chapter 3 discusses those options in detail along with CBO's estimates of the budgetary savings they would generate over the next five years. Important factors in any decision about global restrictions of benefits are the distribution of benefit losses among families by income and type and the administrative issues that each option would raise (see Chapters 4 and 5, respectively, for their consideration). The study's final chapter summarizes the effects of the three options.

Chapter Two

The Major Entitlements: Who Gets Them and Should They Be Means-Tested?

Whether an entitlement program should be subject to a global means test depends on its goals and method of operation. The question calls for considering entitlement programs on several levels: their basic characteristics, how their benefits are distributed among families of different types and with different incomes, and the arguments for and against reducing benefits through some form of global means-testing.

For a number of reasons, the tables showing how benefits are distributed among recipient families may give a misleading picture of who receives assistance (see Box 1). Consequently, readers should be cautious in drawing conclusions based on those data.

Cash Social Insurance Programs

Cash payments make up more than two-thirds of all federal entitlements. The largest cash social insurance programs that the government funds are Social Security and Railroad Retirement, unemployment compensation, and veterans' compensation and pensions.[1]

Social Security

The Congress designed the federal Old-Age, Survivors, and Disability Insurance programs, more commonly known as Social Security, to replace a portion of the earnings a worker loses because of retirement, death, or disability. The programs provide cash payments to retired and disabled workers and to eligible dependents and survivors based on a worker's history of earnings and on his or her family characteristics. The formula used to determine benefits replaces a larger share of lost earnings for people with low earnings than for people with high ones. As a result, Social Security both redistributes income and replaces earnings.

Proponents of including Social Security benefits under a global means test argue that the program pays welfarelike benefits to people who are not poor. For example, the program pays benefits to the spouse of a retired worker equal to one-half of the worker's benefit. The justification for the payments is presumed need--that couples need more income than single people to maintain a given standard of living.[2] But many couples who receive such benefits would not be considered needy under almost any standard.

Surviving children of a deceased worker receive benefits regardless of the surviving parent's income;

1. Because of data limitations, Railroad Retirement is included with Social Security. For similar reasons, veterans' pensions are included in this category, even though they are means-tested. Workers' compensation is omitted from this analysis because it has little effect on the federal budget. Although the program paid out nearly $40 billion for medical services and wage replacement in 1990, the federal government paid only 8 percent of those benefits, primarily to federal employees. Nearly 60 percent of benefits came through private insurers, almost 20 percent came from employers who chose to self-insure, and 15 percent came from state funds.

2. The spousal benefit is limited to 50 percent of the worker's primary insurance amount. The amount may be reduced further if the spouse receives benefits before age 65 or has earnings above specified limits. Social Security pays spousal benefits only to the extent that the spouse's benefits from his or her own employment are less than the amount due him or her as a spouse.

Box 1.
Measuring the Distribution of Entitlements

Statistics in this chapter showing how entitlement benefits are distributed among categories of families come from tabulations of data from the Current Population Survey (CPS), a microdata file created by the Bureau of the Census. The Congressional Budget Office (CBO) has adjusted and supplemented those data to make them more consistent with information from tax returns and administrative records of the entitlement programs examined in this study.

The adjusted file represents the noninstitutionalized domestic population of the United States. The family, defined as related people living together, is the unit of measure CBO uses to analyze who receives benefits. People not living with relatives are counted as one-person families. Family income is all cash income before taxes plus the face value of food stamps that a family receives. Families with zero or negative income are included in calculations of totals but are omitted from individual income categories.

In the tables of distributional data in this study, families are grouped by income and by type--that is, according to the presence of children under age 18 and the age of the family head. *Families with children* are all families with a child under age 18, regardless of who else is present. *Elderly families* are all families with no children and at least one member age 65 or older. *Other families* are thus nonelderly childless families.

Some of the data in the tables may seem anomalous. For example, some families with high incomes appear to receive means-tested benefits that should go only to the poor. These apparently erroneous results occur for one or more of four reasons:

1. Individuals who are themselves poor but who live with relatives with high incomes may qualify for means-tested assistance, even though the larger family of which they are a part would not. For example, a poor elderly parent living with her wealthy adult child could receive Supplemental Security Income (SSI). Such cases are not erroneous.

2. Families may qualify for benefits during part of a year because of low monthly income, even though their total income for the year would make them ineligible. These cases also are not erroneous.

3. Respondents to the CPS may misreport either their incomes or their receipt of entitlement benefits. For example, an elderly recipient of Social Security benefits might mistakenly say that he or she received SSI rather than Social Security. Such errors cannot be detected with certainty and hence may show up in distributional tabulations.

4. Families who are ineligible for benefits may be receiving them anyway, either because of errors in determining eligibility or because the families misrepresented their resources in applying for benefits. Cases in the latter category should be rare, however, because families would be unlikely to respond truthfully to interviewers for the CPS and yet lie to program administrators.

Readers should keep these factors in mind as they consider the distributional data and draw conclusions about whether significant amounts of means-tested benefits go to people with high incomes.

they retain their benefits even if that parent remarries. Consequently, some surviving children in very affluent families receive Social Security benefits, even though their family could support them more than adequately without Social Security.

Another argument for means-testing Social Security benefits asserts that low-income workers should not have to pay 6.2 percent of their cash wages (12.4 percent including the employer share) to provide benefits for high-income retirees. In 1990, families with incomes above $100,000 received more than $8 billion in Social Security benefits. Adherents of this position maintain that Social Security was designed to provide a floor of income protection. It was not intended to subsidize the incomes of people who would have substantially more than adequate means even without Social Security.[3]

3. High-income retirees will generally not receive subsidies in the future because they will have paid more taxes and will get relatively smaller benefits.

An opposing view contends that recipients have paid for their benefits through payroll taxes and that the benefits are thus comparable with those from private insurance and private pensions. In this analogy, survivors' benefits are like the proceeds of a life insurance policy paid out as an annuity, and benefits for retired workers are like payments under a defined benefit pension plan. Yet the differences must be noted as well. Private pensions do not base benefits on family characteristics such as whether the worker has dependents. And benefits from private disability insurance generally depend on workers' earnings at the time of disability--not their earnings in earlier years.

Some opponents of applying a means test to Social Security worry that such a policy would undermine the political consensus supporting the program. Their argument holds that people generally view Social Security benefits as an entitlement that workers have paid for, not a form of welfare. As such, the program has widespread political support that allows for some redistributing of wealth.

Imposing a means test to reduce Social Security benefits for more affluent beneficiaries might be seen as turning Social Security into a program for the poor. Given the historically weak support for welfare pro-

Table 2.
Average Social Security and Railroad Retirement Benefits per Recipient Family Before and After Federal Income Taxes, by Family Income and Type, 1990

Family Category	Average Benefits per Recipient Family (1990 dollars): Before Taxes	Average Benefits per Recipient Family (1990 dollars): After Taxes	Effective Tax Rate (Percent)
All Families	7,880	7,730	1.9
Income (1990 dollars)[a]			
1 to 9,999	5,180	5,180	0
10,000 to 19,999	7,870	7,870	0
20,000 to 29,999	8,870	8,860	b
30,000 to 39,999	9,180	9,090	0.9
40,000 to 49,999	9,180	8,870	3.4
50,000 to 74,999	9,300	8,630	7.2
75,000 to 99,999	8,930	8,060	9.8
100,000 to 149,999	9,750	8,560	12.2
150,000 or more	10,170	8,770	13.8
Type[c]			
With children	6,890	6,870	0.3
Elderly	8,500	8,320	2.1
Other	6,290	6,170	1.8

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTE: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Less than 0.05 percent.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

Table 3.
Percentage of Families Receiving Cash Benefits, Average Benefits per Family, and Benefits as a Percentage of Family Income, by Program, Family Income, and Family Type, 1990

Family Category	Percentage of Families Receiving Benefits	Average Benefits per Recipient Family (1990 dollars)	Benefits as a Percentage of Recipient Family's Income
	Social Security[a]		
All Families	29	7,880	26
Income (1990 dollars)[b]			
1 to 9,999	37	5,180	78
10,000 to 19,999	36	7,870	53
20,000 to 29,999	31	8,870	36
30,000 to 39,999	26	9,180	27
40,000 to 49,999	22	9,180	21
50,000 to 74,999	20	9,300	16
75,000 to 99,999	20	8,930	10
100,000 to 149,999	20	9,750	8
150,000 or more	21	10,170	3
Type[c]			
With children	10	6,890	20
Elderly	94	8,500	28
Other	13	6,290	23
	Unemployment Compensation		
All Families	8	2,230	6
Income (1990 dollars)[b]			
1 to 9,999	4	1,690	25
10,000 to 19,999	8	1,890	13
20,000 to 29,999	9	2,330	9
30,000 to 39,999	11	2,160	6
40,000 to 49,999	10	2,450	5
50,000 to 74,999	9	2,570	4
75,000 to 99,999	8	2,830	3
100,000 to 149,999	6	3,610	3
150,000 or more	4	3,280	1
Type[c]			
With children	11	2,160	7
Elderly	2	2,540	6
Other	9	2,270	7

grams in this country, this perception could weaken the program over time and eventually lead to lower benefits. Or it might give additional momentum to initiatives that allow workers to opt out of Social Security. Moreover, means-testing could encourage many affluent families to rearrange their finances to avoid losing benefits.

Finally, a form of means-testing already applies to Social Security benefits. Recipients with incomes

Table 3.
Continued

Family Category	Percentage of Families Receiving Benefits	Average Benefits per Recipient Family (1990 dollars)	Benefits as a Percentage of Recipient Family's Income
	Veterans' Benefits[d]		
All Families	3	4,470	13
Income (1990 dollars)[b]			
1 to 9,999	3	2,750	43
10,000 to 19,999	3	3,960	27
20,000 to 29,999	3	4,650	19
30,000 to 39,999	4	5,550	16
40,000 to 49,999	4	4,730	11
50,000 to 74,999	4	5,480	9
75,000 to 99,999	5	4,980	6
100,000 to 149,999	4	4,140	3
150,000 or more	2	4,790	2
Type[c]			
With children	2	4,850	14
Elderly	6	3,750	12
Other	3	4,860	13

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

See Box 1 on page 8 for a discussion of how to interpret data on the receipt of benefits.

a. Includes Railroad Retirement benefits.

b. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

d. Veterans' benefits comprise veterans' compensation and veterans' pensions.

above specific thresholds must pay federal income tax on as much as 85 percent of their benefits.[4] Because the thresholds exempt most recipients from any tax liability, however, after-tax benefits were only 2 percent less than total benefits in 1990, when no more than 50 percent of benefits were subject to taxes. At the same time, taxes on benefits are highly progressive: families with incomes under $20,000 paid no taxes on their Social Security in 1990, but families with incomes of more than $100,000 paid federal taxes equal to 12 per-

4. Individuals with countable incomes--adjusted gross income plus tax-exempt interest and one-half of Social Security benefits--above $25,000 and couples with countable incomes above $32,000 pay taxes on up to half of their Social Security benefits. For individuals with incomes above $32,000 and couples with incomes above $44,000, that fraction can be as high as 85 percent.

cent or more of their benefits (see Table 2 on page 9). Tax rates are higher today because the Omnibus Budget Reconciliation Act of 1993 increased the maximum share of benefits subject to taxes from 50 percent to 85 percent.

Social Security is the most broad-based of all entitlement programs, providing significant income support for elderly and low-income families. In 1990, almost 30 percent of all families received Social Security benefits averaging nearly $8,000 (see Table 3 on pages 10 and 11). Almost all elderly families--94 percent--received payments, compared with less than 15 percent of families with no elderly members.

Low-income families were more likely to get benefits than their high-income counterparts--more than one-third versus about one-fifth--largely because retirees generally have lower incomes than workers. Average benefits, however, were smaller for recipients with low family incomes than for those with higher ones--slightly more than $6,600 for families with incomes below $20,000 compared with more than $9,300 for those with incomes above $50,000.[5] But even with lower benefits, low-income families depend more on Social Security for their incomes than do wealthier families: recipient families with incomes under $20,000 get more than half of their income from the program; families with incomes above $50,000 get less than one-sixth.

Unemployment Compensation

Enacted as part of the Social Security Act of 1935, unemployment compensation is a federal/state program paying weekly benefits for a limited period to unemployed workers with a recent history of earnings in jobs that the program covers. The underlying principle of the program is to offset in part the loss of earnings during unemployment and help families maintain their standard of living. The program is, of course, countercyclical: spending rises and falls with the unemployment rate. In periods of relatively high unemployment, the Congress has sometimes enacted additional benefit programs that assist the long-term unemployed.

Both federal and state laws affect the financing and payment of unemployment benefits. Employers pay federal and state payroll taxes into trust funds that finance the regular program. Under general guidelines and some restrictions imposed by the federal government, states establish eligibility requirements, the duration and amount of benefits, and state payroll taxes. The federal government pays all of the program's administrative costs and funds benefits for some groups of workers, primarily federal civilian and military employees.

Because the program applies no means test to unemployed workers, some payments go to individuals in families with significant annual incomes, either from other family members who are working, from the unemployed worker during that part of the year in which he or she was employed, or from nonwage sources. In 1990, families with incomes above $50,000 received nearly one-fourth of all unemployment compensation.

Some observers feel that providing benefits to families with relatively high incomes is an inappropriate use of limited federal resources that could be better spent to help families who are less well off. These critics point to the regressivity of the program's financing and question why low-income workers should have to pay taxes to provide support for much more affluent, though temporarily unemployed, workers. Employers pay taxes on base amounts--ranging from $7,000 to $25,000, depending on the state, but typically $10,000 to $15,000--of each worker's wages to fund unemployment compensation. Economists generally agree, however, that workers actually bear the burden of the tax in the form of lower wages.

Critics also note that the structure of the program encourages unemployed people to spend more time looking for work before they take a job (up to the time limit on benefits) than they would if they were not receiving payments. Workers in more affluent families may be better able than their poorer counterparts to delay going back to work while they look for better opportunities. As a result, they may collect more benefits during each spell of unemployment than their less affluent confreres.

Opponents of applying a means test to unemployment compensation assert that means-testing would have little impact on the federal deficit. Although the

5. Low-income recipients get small benefits because they had low earnings during their working years and therefore also generally have small or no private pensions and little savings.

federal government imposes some guidelines and constraints, states determine tax rates and levels of benefits and administer and fund payments to most beneficiaries. If benefits were cut, states would accumulate larger balances in their trust funds.

States could respond to the higher balances by reducing their payroll taxes or raising the level of benefits. Either way, the federal deficit would be affected only by the reduced benefits paid to federal and military employees, a relatively small part of total payments by the program. However, this argument addresses only the question of whether means-testing would reduce the federal deficit; it ignores the question of whether benefits should be paid to middle- and high-income workers.

Additional arguments against means-testing unemployment compensation rest on the insurance aspect of the program. Workers bear the costs (in the form of lower wages) of insurance premiums paid as taxes on their employers in exchange for a measure of income protection if they should lose their jobs. Consequently, say these arguments, any worker who meets the criteria for eligibility that involve the loss of a job should receive these insurance payments, regardless of other income.

A final contention of opponents to a global means test for this entitlement is that unemployment benefits are already means-tested to some degree in two ways. First, benefits generally replace a fixed share of earnings up to a maximum amount. Lower-income workers thus receive benefits that replace a larger share of earnings than is replaced for higher-income workers.

Second, since the Tax Reform Act of 1986 made all unemployment payments taxable under the progressive rates of the federal income tax, recipients with significant incomes from other sources find their after-tax benefits reduced. Overall, 9 percent of benefits went for federal income taxes in 1990, but the distribution among categories of family income was progressive: recipient families with incomes under $30,000 lost about 7 percent of their unemployment compensation to taxes, compared with roughly 20 percent for those with incomes above $100,000 (see Table 4).

About one family in 12 collected unemployment benefits averaging slightly more than $2,200 in 1990 (see Table 3). Families with incomes between $30,000 and $50,000 were somewhat more likely to draw benefits than families with either higher or lower incomes. At the same time, average benefits generally rose with income from $1,700 for families with incomes under $10,000 to about $3,500 for those with incomes above $100,000. For the poorest families receiving payments, unemployment compensation made up one-fourth of their annual income, compared with less than 5 percent of income for recipient families with incomes above $50,000.

Veterans' Compensation and Pensions

Federal support for military veterans dates back to the 1800s. Today, compensation and pensions constitute the bulk of entitlement spending for veterans.[6] Veterans' pensions provide income for needy veterans and are means-tested, going only to the poorest people who have served in the military. In contrast, veterans' compensation benefits are a form of indemnity payment for those suffering a loss of physical or mental capacity resulting from their military service. The government pays the benefits to veterans and their families regardless of their income.

Although veterans' disability ratings (from 10 percent to 100 percent disabled) may indirectly relate to the loss of earnings associated with a service-connected health condition, for many veterans their specific injuries do not seem to affect their subsequent earnings. As a result, some veterans and their families have substantial incomes in addition to the disability payments. In 1990, nearly 30 percent of payments went to families with incomes above $50,000.

The availability of veterans' benefits to people in high-income families disturbs some observers who place a relatively high value on need as the basis for government benefits. In their eyes, providing payments to disabled veterans with high incomes raises issues of equity: many nonveterans with similar health limitations and much less income are not entitled to any federal benefits. Furthermore, to the extent that service-

6. Although veterans' compensation and pensions differ greatly in terms of who is eligible to receive benefits, the two programs are combined in this analysis because data limitations do not allow accurate distinction between the two.

Table 4.
Average Unemployment Compensation per Recipient Family Before and After Federal Income Taxes, by Family Income and Type, 1990

Family Category	Average Benefits per Recipient Family (1990 dollars) Before Taxes	After Taxes	Effective Tax Rate (Percent)
All Families	2,230	2,020	9.4
Income (1990 dollars)[a]			
1 to 9,999	1,690	1,630	4.0
10,000 to 19,999	1,890	1,750	7.3
20,000 to 29,999	2,330	2,150	7.8
30,000 to 39,999	2,160	1,970	9.0
40,000 to 49,999	2,450	2,200	10.4
50,000 to 74,999	2,570	2,270	11.8
75,000 to 99,999	2,830	2,410	14.9
100,000 to 149,999	3,610	2,810	22.0
150,000 or more	3,280	2,640	19.4
Type[b]			
With children	2,160	2,130	1.3
Elderly	2,540	2,170	14.6
Other	2,270	1,910	16.0

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTE: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

connected disabilities do not affect whether a veteran can earn a living, some people would argue that disability payments are not warranted in such cases. Also to be considered, however, is that a policy that would restrict indemnity payments for those veterans who have overcome major health limitations and been successfully integrated into the work force could undermine work incentives.

Only 3 percent of families received veterans' compensation or pensions in 1990, when payments averaged nearly $4,500 (see Table 3). Families with incomes above $30,000 were somewhat more likely than poorer families to collect benefits, but average benefits varied irregularly with income. Low-income recipients relied heavily on these benefits: families with incomes below $10,000 received more than 40 percent of their total income from veterans' programs.

Agricultural Price and Income Supports

Support for farmers takes many forms. The federal government makes direct cash payments to them, limits production and purchases commodities to bolster prices, and offers low-interest loans.[7] The government also pays farmers when they lose crops as a result of natural events such as flood or drought. The heavily subsidized federal crop insurance program and direct disaster payments are the mechanisms used for those

7. Although this section discusses payments to farmers, the distributional analyses and policy options in the rest of the study exclude them for two reasons. First, available data on the distribution of payments from farm programs are not consistent with data on the distribution of benefits from other programs. That discrepancy makes it difficult to combine the data meaningfully. Second, because payments by farm programs are tied to the production of certain crops on specific pieces of land--and not to individual farmers--limiting benefits for individuals may require a completely different approach from that used for other entitlements.

transfers. All of these farm programs enhance farmers' incomes. They also smooth them--payments rise when prices are low or when natural disaster strikes, and fall when prices rise.

The payments often considered most similar to other federal entitlements are deficiency payments. Farmers receive them for participating in programs for wheat, feed grains (corn, sorghum, barley, and oats), rice, or cotton. The payment rate per unit of a particular crop depends on market prices: rates rise--to make up for "deficiencies"--when market prices fall and fall when market prices rise.

Between one-third and one-half of the nation's 2.1 million farms receive deficiency payments. Producers of agricultural commodities other than grains or cotton--for example, soybeans, sugar, peanuts, tobacco, and dairy products--receive support from the federal government in other ways. Producers of livestock, fruits, and vegetables receive little direct support.

Eligibility for deficiency payments is tied to the land--a key difference between agricultural programs and other federal entitlements discussed in this study. Farmers can receive payments only if the land they are farming has an "acreage base." (An acreage base is an officially recognized amount of land on a particular farm that is eligible for benefits.) Past production on the farm determines acreage bases, which are specific to individual crops. Thus, farms may have a wheat base, a corn base, a sorghum base, and so on.

To receive payments, farmers must also comply with other aspects of the programs. Programs may require farmers to adopt measures to reduce soil erosion or meet requirements to set aside some acreage from production. The latter typically vary from year to year depending on market conditions.

The law limits annual deficiency payments to individual farmers to $50,000. But farmers can also receive payments as shareholders in corporations. Some could receive as much as $100,000 in payments annually--$50,000 as an individual plus $25,000 as a shareholder in a maximum of two corporate farms (each of which could receive a maximum payment of $50,000). Annual deficiency payments averaged $6.3 billion during the 1990-1993 period.

Some quite well-to-do individuals and corporations receive deficiency payments. Data from 1990 from the Internal Revenue Service show that among farms organized as sole proprietorships, about $270 million in program payments went to 29,000 farmers with adjusted gross incomes from nonfarm sources exceeding $100,000.[8] Another $150 million went to 19,000 farmers with adjusted gross incomes from nonfarm sources of between $75,000 and $100,000.

Sole proprietorships received about 75 percent of all farm program payments, with the remainder going to partnerships, family corporations, and other corporations. Corporations and partnerships received higher average payments than sole proprietors, but information about their financial condition is not available.[9] Although no means test now applies to recipients of deficiency payments, the Administration recently proposed one: any individual with annual income from off-farm sources of more than $100,000 would be ineligible for payments.

Proponents of means tests for deficiency payments argue that the limited resources available to farm programs should be better targeted. They cite as appropriate goals those of eliminating poverty among farm families, keeping financially vulnerable farmers afloat, and encouraging more small or middle-size "family" farms rather than very large farms.[10] Although the three goals are somewhat different, they would all be consistent with reducing payments to those farmers, farm corporations, and landowners who would be considered wealthy by most standards.

Opponents of means-testing eligibility for deficiency payments maintain a different viewpoint. They argue that such payments are meant not only to help the poor but to support an industry that provides an abun-

8. Michael Compson, "Limiting Farm Program Payments: The Impact on Farm Sole Proprietors," *Agricultural Income and Finance--Situation and Outlook Report* (Department of Agriculture, February 1994), p. 53. Program payments reported in this study include some Conservation Reserve Program payments and some disaster benefits in addition to deficiency payments.

9. Robert D. Reinsel, *The Distribution of Farm Program Payments, 1987*, Agricultural Information Bulletin 607 (Department of Agriculture, June 1990).

10. For a more complete discussion, see Daniel A. Sumner, *Targeting Farm Programs* (Washington, D.C.: Resources for the Future, National Center for Food and Agricultural Policy, October 1989).

dant, safe, and relatively cheap food supply to the U.S. public. Opponents also claim that reducing support for the agricultural industry could hurt farms of a relatively efficient size as well as the competitive position of U.S. farm commodities in world markets. Some environmental groups that have opposed means tests for deficiency payments add another justification: the receipt of program benefits is a powerful lever to get farmers to adopt measures for soil conservation and water quality protection.

An additional complication of limiting deficiency payments is that it is hard to do--or at least hard to do in a way that reduces federal outlays. The government makes deficiency payments to the individual who raises a qualifying crop on a particular piece of land. The land defines the eligibility for payments. If one person becomes ineligible, another can take over production of the crop by buying or renting the land. The second person then becomes eligible for payments.

Because those payments are potentially large, the incentives are strong to organize farm businesses and land-tenure arrangements to maximize them. Many such reorganizations have occurred in response to past changes in limitations on payments or in eligibility rules. The reorganizations cause savings in outlays to be far less than might be indicated by the initial distribution of the payments.

Yet such reorganizations may serve other objectives of farm policy. For example, they might encourage smaller farming operations. Or a larger share of payments might go to farmers that almost everyone would consider "needy." In addition, eliminating payments to wealthy farmers might quiet critics of the rest of the farm program. These reorganizations, however, use resources that might be better used elsewhere and may create less efficient farming units.

Although it is possible to make certain people ineligible to receive deficiency payments, it is much more difficult to stop them from indirectly benefiting from the programs. The unavoidable fact of current farm programs is that although individuals receive the payments from the government, the right to benefits is associated with the land. Sales prices and rental rates for farmland reflect the value of that entitlement. Eliminating payments to a wealthy owner-operator might cause him or her to rent the land to several smaller operators, who would be eligible for payments. The rent charged for the land would be higher than if no government payments were associated with it. The wealthy landowner would continue to reap most or all of the benefits of the government program, even though he or she was ineligible for payments.

Some people have advanced proposals that would make the individual, rather than the land, the source of eligibility for deficiency payments. That change would enable more accurate targeting of benefits, but it would dramatically alter the nature of the farm programs. Instead of supporting the industry, benefits would support certain individuals who were farming at some specific time. Critics fear that under a change of that kind, farm programs might become more like welfare programs. Supporters believe that tying benefits to individuals, rather than to the land and how it is used, would lead to a more efficient and more market-oriented farm sector.

Federal Civilian and Military Retirement Programs

The federal government will pay pensions totaling about $66 billion to nearly 2.5 million retired civilian workers and more than 1.5 million military retirees in fiscal year 1994. Over the next decade, spending for federal pensions is projected to grow at an annual rate of 1 percent after adjusting for inflation. Because government civilian and military personnel may retire long before age 65--many military service members retire in their 40s--they may pursue second careers while they collect retirement benefits. As a result, many recipient families have above-average incomes.

In 1990, families with incomes above $50,000 received about one-third of federal civilian pensions and more than half of all military pensions--a total of nearly $23 billion. Overall, slightly more than 2 percent of families received civilian pensions and another nearly 2 percent received military pensions from the government; annual payments averaged about $14,300 and $13,500, respectively (see Table 5). For those families, federal pensions made up about one-third of the incomes of civilian retirees and about one-fourth of those of military retirees.

Table 5.
Percentage of Families Receiving Federal Civilian and Military Pensions, Average Pension per Recipient Family, and Pensions as a Percentage of Family Income, by Program, Family Income, and Family Type, 1990

Family Category	Percentage of Families Receiving Pensions	Average Pension per Recipient Family (1990 dollars)	Pensions as a Percentage of Recipient Family's Income
		Civilian Pensions	
All Families	2	14,340	34
Income (1990 dollars)[a]			
1 to 9,999	1	b	b
10,000 to 19,999	2	9,160	61
20,000 to 29,999	3	12,230	49
30,000 to 39,999	3	14,230	41
40,000 to 49,999	3	17,760	39
50,000 to 74,999	3	19,480	32
75,000 to 99,999	3	19,670	23
100,000 to 149,999	3	25,190	21
150,000 or more	3	25,490	9
Type[c]			
With children	1	b	b
Elderly	6	14,550	34
Other	1	b	b
		Military Pensions	
All Families	2	13,460	27
Income (1990 dollars)[a]			
1 to 9,999	d	b	b
10,000 to 19,999	1	b	b
20,000 to 29,999	1	b	b
30,000 to 39,999	2	11,370	32
40,000 to 49,999	3	12,850	29
50,000 to 74,999	3	14,280	23
75,000 to 99,999	3	23,550	27
100,000 to 149,999	4	19,680	17
150,000 or more	2	33,770	8
Type[c]			
With children	1	b	b
Elderly	3	13,200	22
Other	2	14,320	29

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

See Box 1 on page 8 for a discussion of how to interpret data on the receipt of benefits.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Too few families received benefits to allow estimation of a statistically meaningful value.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

d. Less than 0.5 percent.